



# The 6<sup>th</sup> Asia Regional Committee

Annual Meeting & International Conference

Bali - Indonesia, March 27 - 29, 2008

**“Supervision and Management of Small Banks from  
the viewpoint of Asian Deposit Insurers”  
-Experience in India and Asian Region-**

**March 27, 2008**

**Asia Regional Committee: Research Subcommittee**

# Contents

1. Introduction
2. Case Presentation: India
3. Case Presentation: Korea
4. Case Presentation: Viet Nam
5. Conclusion

The 6<sup>th</sup>  
Asia Regional  
Committee

Annual Meeting & International Conference  
Bali - Indonesia, March 27 - 29, 2008

# 1. Introduction

- “Small Banks” are most relevant from the angle of deposit insurers.
- Financial Stability Forum’s Guidance for “Developing Effective Deposit Insurance Systems” defines the principal objectives of a Deposit Insurance System (DIS) as “contributing to the stability of country’s financial system and protecting *less financially sophisticated depositors* from the loss of their deposits when banks fail”.

# 1. Introduction (contd.)

- Deposit insurance cover only up to a fixed limit – meant to protect small and less sophisticated depositors.
- Most of the deposits mobilized by Small banks owned by small, uninformed depositors.
- However, the term “Small Banks” not specifically defined by countries in our region.

# 1. Introduction (contd.)

- ARC Research Subcommittee's Small Banks group has attempted to describe the "Small Banks" and their significance in their respective countries
- Every country in the region has its own way of describing the Small Banks
- These banks have common social and economic significance in several aspects in this region.

# 1. Introduction (contd.)

- Although most relevant for deposit insurers, the Small Banks are most vulnerable to failures – a matter of concern for deposit insurers and supervising authorities.
- We will try to find the common issues regarding the Small Banks with the Case Presentation by three participants of this project.

# 1. Introduction (contd.)

## Issues regarding the Small Banks to be Addressed by Case Presentations

- 1) Definition
- 2) Significance
- 3) Demerits
- 4) Past Experience/Provisions Taken

The 6<sup>th</sup> Asia Regional Committee  
Bali - Indonesia, March 27 - 29, 2008



## 2. Case Presentation: India

### Definition of Small Banks

- To understand the concept of “Small Banks” in the Indian context it is necessary to have a look at the banking system in India and the relative scale of operations of each category of participants.
- For a simple treatment, the most common variables, relevant to deposit insurers, will be used for comparing the relative size of different categories of banks.



## 2. Case Presentation: India - Definition of Small Banks (contd.)

(INRs in billions as on 31.03 2007)

Category of Banks	No. of Banks	% of No. to Total	No. of Branches	Amount of Deposits (INR in Billions)	% to Total Deposits
<b>Public Sector Banks</b>	<b>28</b>	<b>33.7</b>	<b>49,906</b>	<b>19,942</b>	<b>73.9</b>
i) Nationalised Banks	20	24.1	35,848	13,607	50.4
ii) SBI Group	08	9.6	14,058	6,335	23.5
<b>Private Sector Scheduled Commercial Banks</b>	<b>25</b>	<b>30.1</b>	<b>7,067</b>	<b>5,520</b>	<b>20.5</b>
<b>Foreign Banks</b>	<b>30</b>	<b>36.2</b>	<b>272</b>	<b>1,508</b>	<b>5.6</b>
<b>Total of All Scheduled Commercial Banks</b>	<b>83</b>	<b>100</b>	<b>57,245</b>	<b>26,970</b>	<b>100</b>

## 2. Case Presentation: India - Definition of Small Banks (contd.)

(INRs in billions as on 30.06.2006)

Category of Banks	No. of Banks	No. of Branches	Total Deposits (INR in Billions)	Average deposit per Bank (INR in Billions)
Regional Rural Banks (RRBs)	96	14,506	831.47	8.66
Local Area Banks	4	30	3.88	0.97
Urban Co-operative Banks (UCBs)	1,813	7,548	1209.83	0.67
State Co-operative Banks	31	NA	454.05	14.65
District Central Co-operative Banks	366	NA	875.32	2.34

## 2. Case Presentation: India - Definition of Small Banks (contd.)

Bank Group	No. of Banks as per Deposits				
	< INR 10 Billion	Between 10 & 100 Billion (INR)	Between 100 & 500 Billion (INR)	Between 500 & 1000 Billion (INR)	> INR 1000 Billion
Nationalised Banks (20)	Nil	Nil	09	07	04
SBI Group (8)	Nil	Nil	07	Nil	01
Private Sector Sch. Banks (25)	02	11	09	02	01
Foreign. Banks.(29)	17	08	04	Nil	Nil

## 2. Case Presentation: India - Definition of Small Banks

Bank Group	No. of Banks as per Deposits				
	< INR 10 Billion	Between 10 & 100 Billion (INR)	Between 100 & 500 Billion (INR)	Between 500 & 1000 Billion (INR)	> INR 1000 Billion
Regional Rural Banks (96)	69	27	Nil	Nil	Nil
LABs (04)	04	Nil	Nil	Nil	Nil
UCBs (1,813)	1,798	15	Nil	Nil	Nil
SCBs (31)	28	03	Nil	Nil	Nil
DCCBs (366)	366	Nil	Nil	Nil	Nil

## 2. Case Presentation: India - Definition of Small Banks (contd.)

- A huge gap exists between the deposit base of Scheduled Commercial Banks on the one hand and RRBs, LABs, UCBs, and Rural Co-operative Banks (i.e. State Co-operative Banks and District Co-operative Banks) on the other.
- The difference between the two groups is so huge that there is no need to put a dividing line in terms of any monetary limit to differentiate between them.

## 2. Case Presentation: India - Definition of Small Banks (contd.)

- Thus, although small banks have not been formally defined in India, they clearly stand out as the bank group comprising RRBs, LABs, UCBs, and Rural Co-operative Banks.
- The LABs have relatively recent origin & are insignificant in number.
- Though some of the RRBs are weak, these have not impacted the DICGC so far.

## 2. Case Presentation: India - Definition of Small Banks (contd.)

- Although the financial health of Rural Co-operative Banks is not good, they too have not impacted the DICGC so far. They have been protected as a matter of State policy, because they serve an important social objective by catering to the needs of the poorest in the society.
- Presently, the main thrust of DICGC is on UCBs as it had to pay substantial claims to depositors of UCB.



## 2. Case Presentation: India - (i) Significance of Small Banks

- On account of their local feel and familiarity, RRBs, UCBs and Rural Co-operative Banks are important for achieving greater financial inclusion.
- These banks provide banking services to small, weak and financially less sophisticated depositors and borrowers and serve a larger social objective.

## 2. Case Presentation: India - (ii) Demerits of Small Banks

- Most of the problems faced by the Urban and Rural Co-operative Banks are due to poor management, resulting from:
  - Lack of professionalism in managing banking functions
  - Excess politicization of Co-operative bank managements
  - Dual control over Co-operative banks; Management and Audit functions being with the Co-operative Department of the State Government and supervision over their banking activities with the Central Bank (i.e. Reserve Bank of India)

## 2. Case Presentation: India - (ii) Demerits of Small Banks

- Since borrowings from co-operative banks are linked to one's shareholding (a depositor need not be a shareholder), the borrowers have a better say than depositors in the bank's management.
- This has the potential of influencing the Boards to take decisions that may not always be in the interest of the depositors who constitute the most important stakeholders of a bank.

## 2. Case Presentation: India - (ii) Demerits of Small Banks

- Because of their large number and branch network, small banks pose problems in supervision, regulation and monitoring by the regulator (RBI) and the DICGC.
- Small financial base makes it difficult for these banks to adopt modern technology for their operations and provide the requisite information to the Regulator and the DICGC on time.

## 2. Case Presentation: India - (ii) Demerits of Small Banks

- Liquidators of failed small banks many-a-time find it difficult to submit the claim list to the DICGC for want of proper records, delaying payment to the depositors.

## 2. Case Presentation: India - (iii) Deposit Insurance

- Mandatory cover & uniform flat rate premium
- Pay Box System of deposit insurance
- Limited to INR 100,000 (US \$ 2,500) per depositor (2.72 times per capita GDP)
- Commercial banks account for 85.2 per cent of the insured deposits, the RRBs 4.1 per cent and the co-operative banks 10.7 per cent (as on 31.03.2007)

## 2. Case Presentation: India - (iii) Deposit Insurance

- Fully Protected Deposit Accounts: 95% of total number of accounts
- Insured Deposits: 59% of total assessable deposits
- Insured accounts : 683 million; Insured deposits : U.S \$ 352 billion; Reserve Ratio : 0.77 %



## 2. Case Presentation: India - (iii) Deposit Insurance

- Premium received in 2006-07: 91% from commercial banks (including RRBs & LABs) & 9% from co-operative banks.
- Claims paid in 2006-07: 1.0% to commercial banks & 99% to co-operative banks.
- The past trend has been almost the same, showing huge cross subsidization because of flat rate of premium

## 2. Case Presentation: India - (iv) Past Experience

- Mushrooming growth of UCBs (1993-2001)
- Weak governance, managerial failures, poor financial health
- Dual Control
- Vast diversity among UCBs in the levels of professionalism, standards of corporate governance, access to advanced technology and size of business

## 2. Case Presentation: India - (iv) Past Experience

- Till the year 2000, claims from commercial banks (INR 1902 million) were more than those from co-operative banks (INR 719 million).
- Reversal of trend thereafter – the above figures for the period 2000-2001 to 2003-04 aggregated INR 1173 mn & INR 6649 mn respectively.
- Failure of a few large UCBs since 2001
- Out of total claims of US \$ 650 million admitted for all banks so far, over 88% was in respect of 176 UCBs alone

## 2. Case Presentation: India

### (v) Steps Taken (For UCBs)

- Bank / branch licensing on hold since April 2005
- Two Tier regulatory Structure
- MoU/TAFCUB mechanism
- Merger guidelines
- Fit and proper criteria for CEOs
- Incentives for stronger banks in MoU States

# Case Presentation: India

## (v) Steps Taken (For UCBs)

- Graded Supervisory Action
- Restructuring of problem banks - our experience.
- Scheme of amalgamation
- Expeditious settlement of claims: revised guidelines
- Coordination mechanism between DICGC and RBI

# Case Presentation: India

## (vi) Looking Ahead

- Move from extended pay box system to being a part of the resolution process, preferably at an incipient stage.
- Least cost resolution of failed banks and faster settlement of claims
- Maximum use of technology in DICGC as also the insured banks for faster settlement of claims

# Case Presentation: India

## (vi) Looking Ahead

- Legislative and procedural reforms for aligning regulations with best international practices, but at the same time, a more relaxed approach for smaller units such as RRBs, UCBs, SCBs, DCCBs etc. without compromising on solvency and liquidity principles.





# The 6<sup>th</sup> Asia Regional Committee

Annual Meeting & International Conference

Bali - Indonesia, March 27 - 29, 2008

**Thank you for your attention**

